COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 0363-05
Bill No.: SCS for SB Nos. 26, 11, & 31
Subject: Business and Commerce; Taxation and Revenue-Income
Type: Original
Date: February 27, 2013

Bill Summary: This proposal would change certain individual and corporate income tax provisions.

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
General Revenue	$0	($1,181,095,695)	($1,202,240,259)
Total Estimated Net Effect on General Revenue Fund	**$0**	**($1,181,095,695)**	**($1,202,240,259)**

ESTIMATED NET EFFECT ON OTHER STATE FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on Other State Funds	**$0**	**$0**	**$0**

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 13 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON FULL TIME EQUIVALENT (FTE)			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
General Revenue	0	4 FTE	4 FTE
Total Estimated Net Effect on FTE	**0**	**4 FTE**	**4 FTE**

☒ Estimated Total Net Effect on All funds expected to exceed $100,000 savings or (cost).

☒ Estimated Net Effect on General Revenue Fund expected to exceed $100,000 (cost).

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2014	FY 2015	FY 2016
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Sections 143.011 and 143.013, RSMo. Personal Income Taxes:

Officials from the **Department of Revenue (DOR)** noted that a similar proposal (SB 11, LR 0206-01, 2013) would allow an individual to subtract from federal adjusted gross income the amounts of business income as defined to the extent included in federal adjusted gross income when determining the individual's Missouri adjusted gross income. The deduction would be phased in over five years.

Fiscal impact

DOR officials noted that for calendar year 2011, Missouri individual income tax filers reported $11.7 billion in business income on Schedule C, Schedule D, Schedule E, and Schedule F for their federal 1040 forms. DOR officials included the total reported income in the calculation, although some portion of the $11.7 billion reported income could have been earned outside the state of Missouri and thus, not have been taxable in Missouri. On the other hand, the $11.7 billion does not include Missouri business income on a federal return filed by an individual that did not have a Missouri address.

Based on that $11.7 billion in business income, and at the current tax rate of 6 percent, the Department estimates the following reduction in individual income tax:

10% deduction	$70.2 million
20% deduction	$140.4 million
30% deduction	$210.6 million
40% deduction	$280.8 million
50% deduction	$351.0 million

ASSUMPTION (continued)

Administrative impact

DOR officials assumed the Department would need to make form changes, and the Department and ITSD-DOR would need to make programming changes to various tax systems.

In order to implement the proposal, DOR officials assumed Personal Tax would require two additional Temporary Tax Employees for key entry, one additional Revenue Processing Technician I (Range 10, Step L) per 19,000 additional errors, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,400 pieces of correspondence.

Collections and Tax Assistance (CATA) would require one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the non-delinquent tax line, including one CARES phone and agent license, one additional Tax Collection Technician I (Range 10, Step L) for every additional 15,000 contacts annually to the delinquent tax line, including one CARES phone and agent license, and one additional Revenue Processing Technician I (Range 10, Step L) for every additional 4,800 contacts annually to the field offices with a CARES phone and agent license.

The DOR estimate of the cost to implement this proposal included two additional temporary tax employees and seven additional FTE. The estimate, including salaries, benefits, equipment, and expense, totaled $301,123 for FY 2014, $302,032 for FY 2015, and $305,199 for FY 2016. The DOR response did not separately estimate the cost for the personal income tax and corporate income tax provisions.

Oversight assumes the DOR estimate of expense and equipment cost for the new FTE could be overstated. If DOR is able to use existing desks, file cabinets, chairs, etc., the estimate for equipment for the first fiscal year could be reduced by roughly $6,000 per new employee.

Oversight also assumes that a substantial majority of individual tax filers would use tax preparation software or have their return prepared by a paid preparer. Accordingly, the number of calculation errors would be significantly reduced over previous years and the DOR estimate of additional FTE may be overstated. Oversight assumes this proposal could be implemented with four additional FTE. Oversight will include the four additional FTE for six months of FY 2015.

ASSUMPTION (continued)

Oversight has, for fiscal note purposes only, changed the starting salary for the additional employees to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research. Oversight has also adjusted the DOR estimate of equipment and expense in accordance with OA budget guidelines. Finally, Oversight assumes a limited number of additional employees could be accommodated in existing office space.

Officials from the **Office of Administration, Division of Budget and Planning (BAP)** provided the following response:

BAP officials noted that this proposal would make various changes to income taxes. BAP provides estimates of the various provisions independently of the others. Interplay between the provisions could mean the net impact differs from the sum of the various estimates below. These proposals may impact other economic activity, but BAP does not have data to estimate the potential revenue impact.

This proposal would reduce the top marginal individual income tax rate from 6.0% to 4.5%. In FY12, $4,913.9 million in net income taxes was collected at the 6% rate. Based on this estimate, reducing the rate to 4.5% would reduce general and total state revenues by roughly $1,228.5 million.

However, not all taxpayers pay taxes at the highest marginal tax rate. Applying the new tax rates to marginal income data from tax year 2011 supplied to BAP by DOR, BAP estimates this proposal may reduce General and Total State Revenues by $1,072.0 million. MU-EPARC may have a more precise estimate.

This proposal would also phase in a deduction of business income from individual income tax; increasing from 10% in 2014, to 20% in 2015, to 30% in 2016; to 40% in 2017; and to 50% each year thereafter. Business Income is defined as income greater than zero arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

ASSUMPTION (continued)

BAP does not have data that specifically identifies taxable "business income". The IRS, in its Statistics of Income estimates for MO, provides the data in the chart below from tax year 2010. BAP notes it is possible that Capital Gains or Dividend Income, as well as additional forms of income, could be included in business income in certain cases. Therefore, BAP estimates business income to exceed \$10.5 billion. At the highest 6% marginal tax rate, the exclusion of 50% of business income could exceed \$315.8 million, notwithstanding any inflationary growth. BAP officials provided this chart showing the potential personal income subject to deduction under the proposal.

Adjusted Gross Income (\$ millions)	\$135,415
Business Income	\$3,960
Partnership Income	\$6,565
Sub-total	\$10,525
Percent of Adjusted Gross Income	7.7%
Ordinary Dividends	\$3,295
Qualified Dividend	\$2,680
Net Capital Gain	\$3,803
Subtotal	\$9,777
Percent of Adjusted Gross Income	7.2%
Total	\$20,302
Total Percent of Adjusted Gross Income	15.0%

ASSUMPTION (continued)

Oversight notes that the $10.5 billion in business income referred to in the BAP comment includes only the Business Income and Partnership Income in the chart above. If the Ordinary Dividends, Qualified Dividends, and Net Capital Gains in the chart above and referred to in the BAP response would be considered business income subject to deduction under this proposal, the total business income subject to deduction would be $20,302 or nearly twice as much as the initial BAP estimate of $10.5 billion, and the revenue reduction resulting from this provision would also be nearly twice as much.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center (EPARC)** provided an analysis of the estimated impact for these provisions.

Personal income tax rates

This legislation would repeal the top three tax brackets, reducing the Missouri personal income tax table to seven brackets. Filers with taxable income over $6,000 would be in the top tax bracket and their income above $6,000 would be taxed at the new maximum tax rate of 4 ½ %. The Missouri personal income tax table would be changed in the following manner:

If the Missouri taxable income is:	The tax is:
Not over $1,000	1 ½ % of the Missouri taxable income
Over $1,000 but not over $2,000	$15 plus 2 % of excess over $1,000
Over $2,000 but not over $3,000	$35 plus 2 ½ % of excess over $2,000
Over $3,000 but not over $4,000	$60 plus 3 % of excess over $3,000
Over $4,000 but not over $5,000	$90 plus 3 ½ % of excess over $4,000
Over $5,000 but not over $6,000	$125 plus 4 % of excess over $5,000
Over $6,000	$165 plus 4 ½ % of excess over $6,000

Using the Net Tax Due from the latest 2011 individual income tax data as our baseline, we find that Net Tax Due is equal to $4,693.390 million. When we reduce the individual rates, we find the Net Tax Due is reduced to $3,626.210 million, a reduction of $1,067.180 million from the baseline estimate. The following estimates include the reduced individual income tax rates and brackets.

ASSUMPTION (continued)

Business Income Subtraction

This legislation would also allow a "business income" subtraction from filers' Federal adjusted gross income when deriving their Missouri adjusted gross income; a 10% subtraction for 2014, a 20% subtraction for 2015, a 30% subtraction for 2016, a 40% subtraction for 2017 and a 50% subtraction for 2018 and beyond.

EPARC officials began by enumerating "business income" for the Missouri 1040. Within our simulations, we equated business income with self-employment income. We then estimated self-employment income by dividing each filer's self-employment tax by their applicable tax rate. Doing so, we estimate aggregate positive "business income" at $7,229,010,965 for 312,226 Missouri filers.

Using the reduced individual rates and a 10% business income subtraction for 2014, we find the Net Tax Due is reduced to $3,604.553 million, a reduction of $1,088.837 million from the baseline; when we include a 20% business income subtraction for 2015, we find the Net Tax Due is reduced to $3,583.472 million; when we include a 30% business income subtraction for 2016, we find the Net Tax Due is reduced to $3,563.110 million; when we include a 40% business income subtraction for 2017, we find the Net Tax Due is reduced to $3,543.683 million; and when we include a 50% business income subtraction for 2018, we find the Net Tax Due is reduced to $3,525.353 million.

ASSUMPTION (continued)

Oversight will use the EPARC estimate of revenue reduction as calculated in the following table. Oversight notes that the personal income tax changes would be effective beginning January 1, 2014 and assumes that tax returns for 2014 would be filed in January 2015, FY 2015

Year	Personal Income Tax Revenue	Revenue Reduction
Baseline	$4,693,390,000	NA
FY 2015	$3,604,553,000	$1,088,837,000
FY 2016	$3,583,472,000	$1,109,918,000
FY 2017	$3,563,110,000	$1,130,280,000
FY 2018	$3,543,683,000	$1,149,707,000
FY 2019	$3,525,353,000	$1,168,037,000

Section 143.71, RSMo. Corporate Income tax Rate:

In response to a similar proposal (SB 11, LR 0206-01, 2013), officials from the **Department of Revenue (DOR)** noted that the proposed change to this section would change corporate income tax rates. DOR officials noted that Missouri corporate taxpayers reported $5.6 billion in taxable income and $350 million in tax for 2010.

Administrative impact

DOR officials assumed the Department would need to make form changes, and the Department and ITSD-DOR would need to make programming changes to various tax systems.

Corporate tax would require one additional Revenue Processing Technician I (Range 10, Step L) per 7,800 additional errors generated, with CARES equipment and license, and one additional Revenue Processing Technician I (Range 10, Step L) per 2,600 additional pieces of correspondence generated, with CARES equipment and license.

ASSUMPTION (continued)

The DOR estimate of the cost to implement this proposal included two additional temporary tax employees and seven additional FTE. The estimate, including salaries, benefits, equipment, and expense, totaled $301,123 for FY 2014, $302,032 for FY 2015, and $305,199 for FY 2016. The DOR response did not separately estimate the cost for the personal income tax and corporate income tax provisions.

Oversight assumes that a simple rate change for corporate income taxes could be implemented by DOR at no, or minimal, additional cost since virtually all corporate tax returns would be prepared by a corporate official or a tax professional. If unanticipated costs are incurred or if multiple proposals are implemented which increase the DOR workload, resources could be requested through the budget process.

Officials from the **Office of Administration - Division of Budget and Planning (BAP)** noted that this proposal would reduce the corporate income tax rate from 6.25% to 4.75% for 2014 and beyond. In FY 2012, $275.6 million in net corporate taxes was received. Notwithstanding any inflationary growth, this proposal would reduce General and Total State Revenues by $66.1 million in FY 2015.

Officials from the **University of Missouri, Economic and Policy Analysis Research Center (EPARC)** provided an analysis of the estimated impact for this provision:

This proposal would reduces the corporate income tax rate from 6.25% to 4.75% in 2014. The latest 2010 corporate income tax data indicates an aggregate liability of $383.905 million. Using this figure as our baseline and reducing the corporate tax rate to 4.75%, we see the corporate income tax liability would be reduced to $291.767 million in 2014.

Oversight will use the EPARC estimate of revenue reduction. Oversight notes that the corporate income tax changes would be effective beginning January 1, 2014 and assumes that tax returns for 2014 would be filed in January 2015, FY 2015. The revenue reduction for FY 2015 and FY 2016 would be ($383,905,000 - $291,767,000) = $92,138,000.

ASSUMPTION (continued)

Bill as a whole responses

Officials from the **Office of the Secretary of State** assumed a similar proposal (SB 11, LR 0206-01, 2013) would have no fiscal impact to their organization.

Officials from the **Joint Committee on Administrative Rules** assume this proposal would have no fiscal impact on their organization.

FISCAL IMPACT - State Government	FY 2014	FY 2015 (6 Mo.)	FY 2016
GENERAL REVENUE FUND			
Cost - Department of Revenue			
Sections 143.011 and 143.013			
Salaries	$0	($46,735)	($109,383)
Temporary employees	$0	($7,800)	($15,756)
Benefits	$0	($27,649)	($55,506)
Equipment and expense	$0	($38,511)	($3,614)
Total	$0	($120,695)	($184,259)
FTE Change - DOR		4 FTE	4 FTE
Revenue reduction - DOR			
Personal income tax			
Sections 143.011 and 143.013	$0	($1,088,837,000)	($1,109,918,000)
Corporate income tax			
Section 143.071	$0	($92,138,000)	($92,138,000)
Total	$0	($1,180,975,000)	($1,202,056,000)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**$0**	**($1,181,095,695)**	**($1,202,240,259)**
Estimated Net FTE Effect on General Revenue Fund	0	4 FTE	4 FTE

FISCAL IMPACT - Local Government	FY 2014 (10 Mo.)	FY 2015	FY 2016
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

This proposal would have a fiscal impact to any small business that is subject to income tax.

FISCAL DESCRIPTION

This proposal would change certain individual and corporate income tax provisions.

* The proposal would change current personal income tax rates so that persons with taxable income in excess of $6,000 would pay 4 ½% of the income over $6,000. Current rates on lower amounts of taxable income would be unchanged.

* The proposal would create an income tax deduction for personal business income, and would phase the deduction in over a five-year period. Taxpayers would be allowed to deduct ten percent of business income for the 2014 tax year; once fully phased-in, taxpayers would be allowed a fifty percent deduction for tax years beginning on or after January 1, 2018. Members of partnerships and shareholders of Subchapter S corporations would be allowed a proportional deduction based their share of ownership.

* The proposal would reduce the corporate income tax rate from the current six and one-fourth percent of Missouri taxable income to four and three-fourths percent effective January 1, 2014.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Office of the Secretary of State
Joint Committee on Administrative Rules
Office of Administration - Division of Budget and Planning
Department of Revenue
University of Missouri - Economic Policy Analysis and Research Center

Ross Strope
Acting Director
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